



Nationwide produces this publication to provide public defined contribution plan sponsors with information about federal legislative and regulatory activity that may be relevant to plan administration and/or design.

Federal Legislative and Regulatory Report

December 2003

I. Washington Update

No pension legislation this year

Congress adjourned this year without acting on any of the proposed pension legislation that was introduced during this year's session. Although it was expected that legislation would be finalized to select a replacement interest rate for the 30-year Treasury bond interest rate that is used in calculating funding costs for defined benefit plans, action on this issue was delayed until next year.

Looking to Next Year...

The Administration has indicated that they intend to introduce another proposal similar to last year's Employer Retirement Savings Account (ERSA), the Retirement Savings Account (RSA) and the Lifetime Savings Account (LSA) in the President's budget proposal for 2005.

Officials from the Nationwide companies met with Department of Treasury representatives in Washington DC to discuss the implications that these might have on the ability of individuals, and specifically public employees, to save and invest for retirement. Those in attendance included:

- Duane Meek, President, Nationwide Retirement Solutions;
- Joe Gasper, President and Chief Operating Officer, Nationwide Financial Services;
- Jerry Bramlett, President and Chief Executive Officer, The 401(k) Company;
- Bridget Flynn, Federal Relations Manager from Nationwide's Government Relations Office; and
- Don Alexander, Former IRS Commissioner and Nationwide's contracted tax counsel.

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Treasury officials – including Pam Olson, Assistant Secretary, and Bill Sweetnam, Benefits Tax Counsel – were very interested in hearing from Nationwide in regard to the concerns about the ERSA, RSA and LSA proposals potentially having a negative effect on long-term retirement savings. Issues important to public sector employees and the need to address these in any potential legislative proposals affecting the current structure of 457, 401(k) and 403(b) plans were also identified.

Nationwide will continue to work with the Department of Treasury and federal legislators on this and other legislative and regulatory initiatives that may affect public sector defined contribution plans and their participants. We will keep you informed of this activity through future monthly legislative reports and ad hoc alerts.

II. SEC proposes new rules regarding mutual fund trading practices

On Wednesday December 3rd, the five-member Security and Exchange Commission voted unanimously to propose new rules that will require a strict trade cut-off time or “hard close” (usually 4 p.m. Eastern Time) for mutual fund companies. These restrictions would require intermediaries and brokers to transmit buy and sell orders to mutual fund companies by this 4 p.m. deadline. If these rules are enacted, mutual fund investors who are either in retirement plans or use brokers for their investment transactions may wind up having their trades delayed by up to a day. A public comment period on these proposed rules will end on February 6, 2004.

The SEC also announced its intentions to propose additional regulations over the next two months to address market timing and fund governance issues. In addition to the late trading rule, the proposed regulations issued by SEC also would require mutual fund companies to:

- adopt certain compliance policies,
- appoint a compliance officer, and
- provide a more thorough disclosure of the way they value the securities in their portfolio and market-timing policies.

Find it online

A copy of the SEC's announcement can be found at www.sec.gov/news/press/2003-168.htm

The proposed rules released this week offer a much stricter approach to this issue than the bipartisan action that was taken by the House of Representatives on November 19th. The Mutual Funds Integrity and Fee Transparency Act (HR 2420), which was passed by a vote of 418-to-2, directed the SEC to issue rules to prevent after-hours trading but required that an exception be included for broker-dealers, retirement plan administrators and other intermediaries. This exception would compel intermediaries to adopt procedures designed to prevent after-hours trading and demonstrate, through an independent annual audit, that this has been accomplished. There was no companion bill introduced in the Senate this year, but it may be considered in 2004.

What this rule could mean for your plan and participants

The SEC proposed rule could be detrimental to your participant's ability to invest for retirement through their defined contribution plan as administrators will have to change their business practices to comply with the firm trading deadline (usually 4 p.m. Eastern Time). Currently, participants can

place their trades up to the close of the market and the administrator batch processes these transactions and submits them to the mutual fund company after-hours.

The new rule will require administrators to impose a much earlier cut-off to allow sufficient time to process and submit orders by the 4 p.m. deadline. This could result in participants receiving “next-day pricing” on transactions. In addition, the changing practices could result in increased administrative costs to comply with the regulations that would ultimately be passed on to participants.

III. Congress Authorizes Major Changes to Medicare

In late November, Congress passed the Medicare Prescription Drug Improvement and Modernization Act of 2003 (H.R. 1), which President Bush signed, into law earlier this month. This sweeping legislation:

- Includes cost containment measures that require individuals with higher incomes to pay larger Medicare Part B premiums.
- Authorizes private sector healthcare providers to compete with Medicare for enrollees, permits the importation of drugs from Canada with certain restrictions.
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- Repeals the IRS requirement that debit cards and stored value cards used to pay medical expenses from FSAs and HRAs must report payments on IRS Form 1099 MISC.

In this month’s report, we will concentrate on the two significant changes to Medicare that could affect employer sponsored health plans, the establishment of:

- Health Savings Accounts beginning in January 1, 2004 providing individuals with another way to pay current and/or future medical expenses
- Medicare standard prescription drug coverage available beginning January 1, 2006 and the incentives offered to encourage employers to maintain retiree prescription drug programs.

Health Savings Accounts (HSAs)

HSAs are tax-exempt trust/custodial accounts created for the sole purpose of accumulating funds to pay for qualified medical expenses of the account holder, the account holder’s spouse or dependents. HSAs expand on the concept of the Archer Medical Savings Account, a pilot program intended to help self-employed individuals and small employers to pay health care costs for employees. Archer MSA’s are expected to be phased out at some point in the future and replaced with HSAs.

HSA’s may be established by anyone who is enrolled in a high deductible health plan and not entitled to Medicare benefits.

Find it online

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_reports&docid=f:hr391.108.pdf
<http://www.ustreas.gov/press/releases/js1045.htm>

The following Q&A illustrates the major requirements of HSAs:

General HSA Requirements	
What are the HSA Trust requirements?	<p>The HSA trustee/custodian must be a bank or non-bank trustee approved by the Internal Revenue Service as a non-bank trustee. HSA trusts/custodial accounts must meet the following requirements:</p> <ul style="list-style-type: none"> • Accept only cash contributions. • Ensure annual HSA contributions do not exceed indexed family coverage limit plus catch-up limits for the year. • Not be invested in life insurance policies. • Must not commingle HSA assets with other assets except in a common trust/investment fund. • Ensure that HSA account holder is 100% vested in his/her HSA account at all times. • Treat HSA assets that are used as collateral for a loan as a taxable distribution. • Terminate the HSA if an account holder has engaged in a prohibited transaction.
What kinds of expenses can be paid with HSA funds?	<p>Expenses for qualified medical care defined under IRC 213(d) for account holder (employee), spouse or dependent as defined under IRC 152 may be paid from the HSA. Health insurance premiums may not be paid from HSAs, except for:</p> <ul style="list-style-type: none"> • COBRA continuation insurance. • Qualified long term care contracts. • Health insurance purchased while receiving unemployment benefits. • Medicare premiums for Medicare enrollees (except for a Medicare supplemental policy). • Retiree medical premiums under employer-sponsored plan.
Who is eligible to establish an HSA?	<p>HSAs may be established by individuals who are covered under a high deductible health plan (HDHP) and who are not covered under a non-high deductible health plan that provides the same benefits as the HDHP.</p> <p>Certain types of non HDHP insurance coverages are permitted such as accident, disability, dental, vision and long term care contracts in addition to unemployment insurance, home-owners and auto insurance, specific disease insurance or hospitalization insurance that pays a fixed amount for a specified period of time for hospitalization.</p> <p>Ineligible individuals are those covered under:</p> <ul style="list-style-type: none"> • Another non HDHP plan such as a spouse's non HDHP. • HRAs or FSAs, unless that coverage is limited to dental and vision coverage. • Medicare.
What are the requirements for a health plan to be an HDHP?	<p>HDHPs must meet two requirements:</p> <ol style="list-style-type: none"> 1. Annual deductible (indexed annually) must be at least \$1,000 for self-only coverage or \$2,000 for family coverage. 2. Out-of-pocket expenses (deductibles and co-pays, but not premiums) are indexed annually and must be capped at \$5,000 for self-coverage or \$10,000 family coverage. <p>Exceptions to limits:</p> <ul style="list-style-type: none"> • Preventive Care plans (Wellness programs) do not have to have a deductible to be considered an HDHP. • Deductibles and benefits provided under network plans (PPOs) for out-of-network services can exceed \$5,000/\$10,000 cap and still be a HDHP but cannot be used to increase contribution limits.

<i>Contributions</i>	
Who may contribute to an HSA?	<p>Eligible individuals, Employers and/or Employees.</p> <p>Eligible individuals may contribute to their HSAs. Family members may also contribute to HSAs of other family members.</p> <p>Employers may contribute to HSA accounts for eligible employees through a cafeteria plan.</p> <p>Employees may contribute to an HSA through a cafeteria plan on a pre-tax basis under a salary reduction agreement.</p>
What are the Annual Contribution Limits?	<p>Dollar limits will be indexed annually.</p> <p>The 2004 limit is the smaller of the:</p> <ul style="list-style-type: none"> • Annual deductible amount or \$2,600 for self-only coverage. • Annual deductible amount or \$5,150 for family coverage. <p>Contributions Aggregation: All contributions to an Archer MSA and other HSAs must be aggregated when applying contribution limits.</p>
Are catch-up contributions available?	<p>Catch-up contributions are available to individuals between the ages of 55 (by the end of the calendar year) and 65. Annual contributions may be increased by:</p> <p>\$500 in 2004 \$600 in 2005 \$700 in 2006 \$800 in 2007 \$900 in 2008 \$1,000 in 2009 and thereafter.</p>
Can HSAs accept rollovers from other plans or be rolled into other plans?	<p>HSAs can accept rollover contributions from Archer MSAs and other HSAs. HSAs may be rolled to other HSAs tax-free if:</p> <ul style="list-style-type: none"> • HSAs funds are rolled over to another HSA within 60 days of receipt of funds. Only one rollover is permitted in any 12-month period. <p>NOTE: Unless later guidance to the contrary is issued it is likely that IRA direct transfer rules will apply to HSAs, which would permit HSA funds to be directly transferred from one HSA trustee to another HSA trustee without limiting the number of transfers in any period.</p>
Are annual HSA limits reduced by rollover contributions?	No, rollovers into HSAs do not affect annual HSA contribution limits.
How are excess contributions to an HSA treated?	<p>Excess contributions and earnings to an HSA are included in gross individual's gross income and may be subject to excise taxes.</p> <ul style="list-style-type: none"> • Contributions and earnings returned after tax filing deadline will be subject to both income tax and the excise tax. • Excise taxes will not apply if contributions and earnings are returned prior to the HSA holder's tax filing deadline.
What happens to HSA funds not spent in a tax year?	<p>Unused HSA funds are carried over from year to year.</p> <p>Individuals with current qualified medical expenses may choose to pay these expenses themselves and let HSA funds accumulate for future medical expenses.</p>

<i>Taxation and Reporting Requirements</i>	
How are contribution and accumulations taxed?	Contributions made by individuals to their HSAs are tax deductible on their personal tax returns even if they do not itemize. Contributions and earnings accumulate tax-free. Employer contributions and salary reduction contributions to a cafeteria plan are not subject to federal income taxes or FICA taxation and accumulate tax-free.
How are HSA distributions taxed?	Distribution for qualified medical expenses is tax-free. Non-qualified distributions will be included in gross income and subject to 10% excise tax. Excise taxes are waived for death, disability of HSA accountholder.
What happens if account holder changes jobs or retires?	HSAs are completely portable (like IRAs) and may be rolled/transferred to other HSAs on tax-free basis.
How is the HSA taxed if the HSA account holder dies?	If designated beneficiary is the surviving spouse, ownership of the HSA can be transferred to the surviving spouse on a tax-free basis. If designated beneficiary is not the spouse, HSA account will no longer be an HSA and HSA assets will be included in income of beneficiary. If there is no designated beneficiary, HSA assets will be included in decedent's estate.
What happens to HSA assets in cases of divorce?	HSA assets may be transferred to the alternate payee-spouse in a non-taxable transfer.

Voluntary Prescription Drug Benefit Program

The second major change to Medicare is the establishment of a voluntary prescription drug program beginning January 1, 2006 and the subsidies paid to employers for retirees who do not use the new Medicare prescription drug program. The purpose of the subsidy is to encourage employers to maintain current employer sponsored retiree prescription drug programs.

This table provides information on the ***Medicare Voluntary Prescription Drug Program***.

Who is eligible for the Medicare Voluntary Prescription Program?	Individuals enrolled in Medicare Part A or eligible for Medicare Part B may voluntarily enroll in this program.
How much will an enrollee in the Medicare standard prescription drug program have to pay?	<p>Enrollees in the Medicare Voluntary Prescription Drug program will pay:</p> <ul style="list-style-type: none"> ➤ Average Monthly Premium is estimated to be approximately \$35/month. ➤ Annual deductible of \$250. ➤ 25% co-payment for drug expenses from \$251 to \$2,250. ➤ 100% for drug costs between \$2,251 and \$3,600. ➤ 5% co-payment (catastrophic coverage) for out-of-pocket expenses above \$3,600 including deductibles and other costs but not premiums). <p>No deductibles or monthly premiums and reduced co-payments are available to for qualified low-income individuals.</p> <p>All dollar limits will be adjusted annually.</p>



<p>What are the requirements for employer subsidies maintaining their own retiree prescription drug programs? How much is the subsidy employers could receive?</p>	<p>To receive tax-free subsidies public and private sector employers will have to:</p> <ul style="list-style-type: none"> ➤ Sponsor retiree prescription drug programs that are the same as or the actuarial equivalent of the standard Medicare prescription drug program (stated above). ➤ Have retirees who do not enroll in the Medicare voluntary prescription drug program. <p>Employers will receive a 28% tax-free payment for the actual net cost of a retiree' prescription drug expenses from \$251 up to \$4,750. Maximum subsidy could not exceed \$1,338 per retiree.</p> <p>Employers will be required to file reports and keep detailed records, which may be subject to government audits.</p>
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IV. Looking Back at 2003 Reports -- Subject Index to Published Articles

The following provides an index of the articles that were included in the monthly legislative reports during 2003, by topic. Past issues of the monthly reports can be found at www.nrsforu.com in the *Employer* section.

1. **Accumulated Sick and Vacation Pay**
 - Contribution to a Retirement Plan & FAQs – March 2003
 - Taxation of Sick and Vacation Pay Distributions (GCM03-0082) – August 2003
2. **Bankruptcy**
 - Bankruptcy Abuse Prevention and Consumer Protection Act (H. R. 975) – June 2003
3. **Blackout Notices for Defined Contribution Plans (Sarbanes Oxley Act)**
 - Final DOL Regulations and Model Amendment – February 2003
 - Blackout Notice Requirements and Government Retirement Plans – September 2003
4. **Catch-up Contributions, Age 50+**
 - Availability in Multiple 457 plans – September 2003
 - Final Regulations – July 2003
 - Ordering of Long-Service and Age 50 + Catch-up Contributions for 403(b) Plans – September 2003
5. **Deemed IRAs**
 - IRS review of Deemed IRA requirements for Government Plans – September 2003
 - Proposed Regulations – June 2003
 - Model Amendment for Deemed IRAs (Rev. Proc 2003-13) – January 2003
 - NRS Comment Letter – July 2003
6. **Defined Benefit Plans**
 - Interest Rate Replacement (Pension Funding and Equity Act, HR 3108) – October 2003
 - i) Update: December 2003
 - Cash Balance Plan Regulations (HR 2989) – November 2003
7. **Employment Taxes**
 - Fraudulent W-4s – September 2003
8. **Family and Medical Leave Act**
 - Court Rules State Employees May Sue for FMLA Violations – June 2003
 - Family and Medical Leave Expansion Act – February 2003
9. **Firefighters, Volunteer**
 - Award Programs (Rev Ruling 2003-47) – May 2003
10. **403(b) Plans**
 - IRS Audits – September 2003



- Plan Termination – September 2003
- 11. **457 Plans**
 - Age 50+ Catch-up, see [Age 50+ catch-up](#)
 - IRS Audits – September 2003
 - Final and Proposed Regulations Comparison Chart – August 2003
 - Timing of Distributions from Rollover Accounts – November 2003
 - Withholding and Reporting Requirements (IRS Notice 2003-20) – May 2003
- 12. **401(k) Plans**
 - Proposed Regulations – August 2003
 - Successor Plans – August 2003
- 13. **Health Benefits**
 - Health Savings Accounts H. R. 2351 – July 2003, see [Medicare](#)
 - Deductible Medical Expenses (IRS 2003-57 and 58) – June 2003
 - FAQ for FSA and HRA Non-Prescription Drug Reimbursements (Rev Ruling 2003-102) – Sept. 2002
 - Retiree Medical Benefits (Funding Methods) – September 2003
 - Taxation of Medical and Dental Benefits for Domestic Partners (PLR 200339001-) – October 2003
 - Taxation of Retirement Plan Distributions Used to Pay Health Care Premiums (Rev Ruling 2003-62) – July 2003
- 14. **Internal Revenue Service**
 - Correction Programs/EPCRS (Rev Proc 2003-44) – July 2003
 - Guidance Priority List for 2003-2004 (IRS Notice 2003-26) – May 2003
 - Types of IRS Guidance (Table) – November 2003
- 15. **Legislation, Retirement Plans-Proposed**
 - Permanency and Acceleration of EGTRRA Contribution Limits (Pension Preservation and Savings Act, HR 1776/Portman-Cardin) – April 2003, May 2003, June 2003
 - Bush Administration Proposals-see Pension Simplification
 - Incentives for annuity distributions (Security Annuity Income for Life Act (SAIL) HR 2458) – June 2003
 - Investment Advice Services for ERISA Plans (Pension Security Act, HR 1000/Boehner) – March 2003, May 2003 and Retirement Security Advice Act (Senate version, S 1698) – October 2003
 - Increased Portability for Spousal and Non-Spousal Beneficiaries (H.R.518 Retirement Account Portability Improvement Act) – January 2003
- 16. **Legislation, Passed** – see [Medicare](#)
- 17. **Medicare**
 - Medicare Prescription Drug Improvement and Modernization Act of 2003 – December 2003
 - Establishment of HSAs – December 2003
 - Voluntary Prescription Drug Program – December 2003
 - Employer Subsidies for Retiree Prescription Drug Programs – December 2003
- 18. **Military Service**
 - Employer/Employee Obligations under USERRA – January 2003
 - USERRA Update – November 2003
- 19. **Mutual funds**
 - SEC Proposed Rules Regarding Mutual Fund Trading Practices – December 2003
- 20. **Paid Leave, Repeal of**
 - For Birth or Adoption of Child from Unemployment Compensation Funds – November 2003
- 21. **Pension Simplification Proposals (Bush Administration)**
 - RSA, LSAs, and ERSAs (Comparison Chart) – February 2003
 - i) Updates: March 2003, September 2003, November 2003
- 22. **Rollovers and Transfers**
 - Difference between Rollovers and Transfers – September 2003



- Waiver of 60-Day Rollover Requirement (Rev Proc. 2003-16) – March 2003
 - [See 457 plans, final regulations](#)
23. **Social Security, Proposed Legislation**
- Mandatory Participation by State and Local Governments (Social Security Solvency Act H.R. 3055) – October 2003
 - Repeal of Current Income Tax Rate on Social Security Payments (S 767) – May 2003
 - Change in Exemption for Government Pension Offset in Divided Systems (Social Security Protection Act of 2003, HR 743) – April 2003
 - Voluntary Participation by State and Local Governments (House Resolution 25) – May 2003
 - Establishment of Voluntary Accounts (Social Security Guarantee Plus Act, HR 75) – May 2003
 - Phase-out of Earnings Test (Social Security Guarantee Plus Act, HR 75) – May 2003
 - Protection of Surpluses (Social Security Solvency Act, HR 3055) – October 2003
 - Reduction of Government Pension Offset (Social Security Guarantee Plus Act, HR 75) – May 2003
24. **Tax Cuts**
- Job Protection and Growth Tax Relief Act of 2003 – June 2003
25. **2004 Retirement Plan, Social Security and Medicare Cost of Living and Other Adjustments (Table) – November 2003**